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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 250

CORNELIUS J. COLLINS, ET. AL.,
Petitioners,

vs.

LESTER L. SEIFRIED,
Respondent.

SHERIDAN VIEW BUILDING CORPORATION,
Debtor.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT AND BRIEF IN SUPPORT THEREOF.

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C. In the Marine Harbor case as distinguished from the present case, no conflict existed between creditors and the debtor did not sustain the burden of establishing good faith which federal statutes place on a petitioner. So far as the "interests" of stockholders were concerned they would not be denied in the State Court any benefits, advantages or protection which Chapter X afforded, as it was conceded the debtor was insolvent. In the instant case a conflict exists among the only class of creditors, and the state court procedure was inadequate as compared with Chapter X to protect all creditors, and the prior foreclosure proceedings is controlled by a person who with selfish interest could be guilty of abuse..... 12

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Debtor.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners Cornelius J. Collins, Jessie Mae Collins, Helen S. Milis, P. A. Caswell and Stanley Lapin respectfully pray this Court for the issuance of a Writ of Certiorari to the United States Circuit Court of Appeals for the Seventh Circuit to review an order of that Court entered on June 6, 1945, reversing an order of the United States District Court for the Northern District of Illinois,

Eastern Division, which approved a creditor's petition for reorganization of the Debtor corporation as filed in good faith and named a Trustee.

Opinion Below.

The opinion of the Circuit Court of Appeals is not yet officially reported but is contained on pages 116 to 119 of the record.

Jurisdiction.

The order of the Circuit Court of Appeals was entered on June 6, 1945. No petition for rehearing was filed. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

Question Presented.

Section 144 of Chapter X of the Bankruptcy Act provides if an answer be filed by a creditor controverting any of the material allegations of the petition the Judge shall determine the issues presented by the pleadings and enter an order approving the petition if satisfied that it complies with the requirements of said chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it, if not so satisfied. Section 146 provides that without limiting the generality of the term "good faith", a petition shall be deemed not to be filed in good faith if "(4) a prior proceeding is pending in any Court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

The question presented is:

Whether under the provisions of Sections 144 and 146 (4) of the Bankruptcy Act a Bankruptcy Court must

relinquish the jurisdiction conferred upon it by Chapter X because of a mere showing that there is pending in the state court an equity foreclosure seeking solely a sale of the property where the only relief that the State Court is required to grant is a sale of the property to the highest bidder under foreclosure decree, and where there is a conflict between creditors, and it appears the creditors received no notice of the foreclosure, were not a party to said proceeding and the sole right of action is vested in the indenture trustee under the trust deed, and that creditors do not have an absolute right of intervention in said state foreclosure proceedings.

Statutes Involved.

The statutes involved are the following provisions of the Bankruptcy Act.

Section 144 (11 U.S.C. § 544): "If an answer filed by any creditor, indenture trustee, or stockholders shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied."

Section 146 (11 U.S.C. § 546): "Without limiting the generality of the meaning of the term 'good faith', a petition shall be deemed not to be filed in good faith if—* * * (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding."

STATEMENT.

The litigants are holders of the debtor's second mortgage bonds, of which $200,800 were outstanding on December 1, 1944, the date of maturity. There is also a first mortgage of $26,000, which is not in default. The capital stock of the debtor, consisting of 2,160 shares of no par common stock, is wholly owned by bondholders as a result of a prior State Court reorganization under which stock control became incident to bond ownership, and by which proportionate interests in stock passes with a transfer of bonds. The principal asset of the debtor is an apartment building in Chicago, Illinois (R. 3, 10, 11, 26).

The bonds were issued pursuant to a trust indenture naming The Trust Company of Chicago as trustee, and empowering holders of 51% of the outstanding bonds to direct and control the acts of the trustee, and to remove the latter at their pleasure (R. 25, 86). The objecting creditor owns more than 51% of the issue. Under the indenture, the debtor waived all rights of redemption in the event of a foreclosure sale (R. 30).

In his statement under Section 210 of the Bankruptcy Act (11 U. S. C. A. §610), Seifried apparent objector to the reorganization petition has listed himself as the holder of $132,800 of bonds acquired between October 9, 1944, and December 19, 1944, which is 66.1% of the outstanding issue (R. 13-14). It appears, however, that the real owner of these securities is one Howard F. Bishop, a Chicago attorney, who purchased them in the name of Seifried at an average price of $68 as against a par value of $100 (R. 24, 32, 47).

On December 2, 1944, one day after maturity and default, Bishop, then holder of more than 51% of the outstanding bonds, and also having a controlling interest in the stock, purporting to act as attorney for Seifried, called upon an officer of the indenture trustee with a prepared bill of foreclosure, secured its proper execution, and arranged for the employment of his law firm as attorney for the trustee (R. 27-29, 35-38). Immediately thereafter, a bill of foreclosure was filed in the Superior Court of Cook County, Illinois, to which the only parties were the indenture trustee as plaintiff and the debtor as defendant. No notice was given to the bondholders of the filing of said proceedings, and the answer of Seifried admits said cause is now ready for decree (R. 11).

It further appears that at the time Bishop as attorney for his nominee, Lester Seifried, made the demand upon the indenture trustee, the Trust Company of Chicago to commence foreclosure proceedings, he failed to disclose to said indenture trustee for whom he proposed to act (as attorney) that he had a personal interest in the ownership of said securities and had, in fact, personally paid for all securities listed in said demand (R. 37).

On December 9, 1944, while the bill of foreclosure was pending, petitioners, minority holders of $5700 of the second mortgage bonds, filed a creditors' petition for reorganization of the debtor under Chapter X of the Bankruptcy Act, noting *inter alia*, the pendency of the bill of foreclosure, and alleging that by virtue of increased real estate taxes, increased operating and labor costs, and rent ceiling, the debtor's assets could not presently be sold at a price fairly commensurate with their real value, that a sale would result only in great loss to the debtor and its creditors, and that relief could be obtained only by a Chapter X reorganization modifying and altering the rights of the secured creditors (R. 2-8). Seifried filed an answer denying that the petition had been filed in good

faith, alleging that reorganization was impossible, and urging that the interests of all bondholders were fully safeguarded in the state court proceedings (R. 9-12). At the hearing on the "good faith" issue it appeared that Bishop had not resorted to the state court foreclosure proceeding pursuant to any plan or program for reorganization, but was in fact seeking a sale of the property under foreclosure decree pursuant to the prayer of the complaint (R. 31). Under the indenture he would be in a position to apply his bonds in payment of the purchase price and secure title free from possibility of redemption by the debtor (R. 43, 73). No opposition to the foreclosure was offered by the debtor. Seifried and his "attorney", Bishop, had been associates in a number of real estate ventures (R. 46 *et seq.*), and the district judge was warranted in inferring that they might wish to use their recently acquired bonds to aid them in acquiring the property as cheaply as possible, and that their own self interest conflicted with that of other bondholders.

On cross-examination it was disclosed that neither Bishop nor the indenture trustee had at any time ever discussed any plan of reorganization in the state court (R. 37).

The answer of Seifried challenged the jurisdiction of the Federal Court and asserted that ample relief could be had in the State Court. By reason of the fiduciary capacity which Bishop and the indenture trustee occupied to all bondholders, we deemed it important to inquire of said fiduciaries, what relief they would obtain for bondholders in the State Court. We therefore quote from the record:

> Mr. Ratner: (representing creditors in the Chapter X proceeding.)
>
> Q. Now, tell me, Mr. Bishop, what is the relief that the bondholders, other than yourself, are going to receive in the State Court?
>
> * * * * *

The Witness: I have been advised by Mr. Swanstrom, who has looked into this matter.

Q. Very well, go ahead.

A. I have been advised by him that under the Bryn Mawr Building case, which I have not gone into in detail, or Bryn Mawr Corporation, that that can be done. I haven't paid any particular attention.

Q. What can be done?

A. That complete relief can be had in the State Court.

Q. What relief?

A. Complete relief, plan, or anything else. I haven't gone into the details of that.

Q. Why hasn't that been submitted to the State Court, then?

A. I couldn't tell you (R. 31-32).

Mr. Townsend, President of the Trust Company of Chicago who was the Indenture Trustee, and without whom a Plan of Reorganization could not be presented testified:

Q. Did you discuss with Mr. Bishop at the time of his demand, or at any other time any Plan of Reorganization?

A. No sir.

Q. Did he discuss that with you?

A. No sir. (R. 37).

The District Judge entered an order on January 5, 1945, approving the petition as having been filed in good faith and appointing a trustee for the debtor and its property (R. 16-21). The instant appeal followed.

Specifications of Errors To Be Urged.

The Circuit Court of Appeals erred:

1. In holding that the creditor's petition for reorganization under Chapter X of the Bankruptcy Act was not filed in good faith.

2. In directing the District Court to dismiss the petition.

Reasons for Granting the Writ.

Many trust deeds involving large properties vest the sole right of action to commence a foreclosure in the indenture trustee. Under such a trust deed in an Illinois foreclosure proceeding the bondholders are not parties to said action, receive no notice of said proceeding and do not have an absolute right of intervention in said foreclosure proceeding. Many foreclosure proceedings involving bond issues where the sole right of action is vested in the indenture trustee have been and are being filed annually in the Illinois state courts. Does the mere pendency of such a proceeding in the name of an indenture trustee to which proceeding bondholders are not a party and have no absolute right of intervention deprive within the meaning of Section 146 (4) the minority bondholders from seeking the protection of Chapter X where a conflict exists between bondholders? If this be true it would result in a race between bondholders as to which forum they deemed best suited for their particular objective. In the instant case there was a conflict between the minority bondholders and the dominant bondholder who was a fiduciary, and as such, his personal interest was antagonistic to the interest of minority bondholders. The bondholders had no notice or voice in the conduct of said foreclosure. The majority bondholder dominated said proceeding and actually conducted said proceeding as the attorney for the indenture trustee. The majority bondholder had the right under the trust deed to remove the indenture trustee at any time. Only in the federal court in a proceeding under Chapter X where each step of the proceeding is subject to the closest scrutiny and upon notice to all bondholders and the approval of the court could the minority bondholders be protected.

We believe the Circuit Court of Appeals in the instant case has misapplied the decision in the case of *Marine Harbor Properties, Inc.*, 317 U. S. 78 (1942) by giving it the effect of excluding Federal jurisdiction because of the mere pendency of a prior State Court foreclosure. The District Judge knew the benefits to be obtained under Chapter X, and took judicial notice of the statutes of the State of Illinois governing the relief that could be obtained in that forum, and the inadequacies incident to State Court foreclosure proceedings. He knew that the majority bondholder could compel a sale of the property in said foreclosure for under the Illinois law the bondholder is entitled to his pro-rata cash distribution under a foreclosure proceedings. He also knew that there was a conflict of interest among creditors, as disclosed by the record and that the foreclosure proceeding was under the very control of the person who with selfish motives could be quilty of abuse. Under such circumstances the District Judge determined that the interests of all creditors could be *better subserved* in the Federal Court. Unless the words "better subserved" are given definite meaning and consideration the very purpose and intention of Congress, in including them in Chapter X would be nullified. It therefore becomes of vital importance to the administration of Chapter X to determine whether it was the intention of the Supreme Court under the Marine Harbor Properties decision, to give the same effect to Section 146 (4) as the Circuit Court of Appeals has in the instant appeal.

PRAYER.

WHEREFORE, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Court, directed to the United States Circuit Court, commanding said Court to certify and send to this Court on

a day to be designated a full and complete transcript of the record and of all proceedings of the Circuit Court of Appeals had in this cause, to the end that this cause may be reviewed and determined by this Court; and that the order of the Circuit Court of Appeals for the Seventh Judicial Circuit reversing the order of the District Court be reversed and remanded and that petitioner be granted such other and further relief as may seem proper.

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Counsel for Petitioners.

DAVID J. RATNER,
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Of Counsel.

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SHERIDAN VIEW BUILDING CORPORATION,
Debtor.

BRIEF IN SUPPORT OF PETITION.

OPINION BELOW.

The opinion of the Circuit Court of Appeals is not yet officially reported but is printed in full in the Record (R. 116-119).

STATEMENT OF THE CASE.

A statement of the matter involved has been fully presented in our petition and the Court is respectfully referred to pages 4 to 9 herein. In the interest of brevity the statement is not repeated here.

Specifications of Errors To Be Urged.

The Circuit Court of Appeals erred:

1. In holding that the creditors' petition for reorganization under Chapter X of the Bankruptcy Act was not filed in good faith.

2. In directing the District Court to dismiss the petition.

SUMMARY OF ARGUMENT.

A. The creditors' petition was not lacking in good faith within the meaning of Section 146 (4) where it appears a prior foreclosure proceeding under Illinois law is inadequate by comparison with Chapter X for the reorganization of the debtor, and where a conflict of interest exists between creditors and the sole right to foreclose is vested in the indenture trustee, creditors not being a party to said foreclosure and receiving no notice of said foreclosure.

B. Where the dominant creditor is a fiduciary by reason of being attorney for the indenture trustee in the state court foreclosure, his conduct must be on a higher level than that of persons dealing at arms length with each other and a bankruptcy court will not permit him to deal with the subject matter of his trust for his own benefit.

C. In the *Marine Harbor* case as distinguished from the present case, no conflict existed between creditors and the debtor did not sustain the burden of establishing good faith which federal statutes place on a petitioner. So far as the "interests" of stockholders were concerned they would not be denied in the State Court any benefits,

advantages or protection which Chapter X afforded, as it was conceded the debtor was insolvent. In the instant case a conflict exists among the only class of creditors, and the state court procedure was inadequate as compared with Chapter X to protect all creditors, and the prior foreclosure proceedings is controlled by a person who with selfish interest could be guilty of abuse.

ARGUMENT.

The Circuit Court of Appeals improperly found that the interests of the creditors and stockholders would be best subserved in the state court prior proceeding as in the instant case the local machinery for reorganization of the debtor is inadequate by comparison with Chapter X.

A.

A foreclosure proceeding under Illinois laws is inadequate by comparison with Chapter X for the reorganization of the Debtor. Under a foreclosure proceeding in the Illinois State Courts the only remedy that the court *must* grant is a sale to the highest and best bidder. Courts of equity having jurisdiction of foreclosure proceedings have general equity powers and have power to protect the interest of creditors and stockholders through reorganization *if the proper parties so desire.*

One of the cases cited in the opinion of the Circuit Court of Appeals in the instant appeal is the case of *First National Bank* v. *Bryn Mawr Beach Bldg. Corp.*, 365 Ill. 409, 9 N. E. 2d 654 (1937). In that case a bid at the master's sale was made by a representative of a *bondholders' com-*

mittee pursuant to an existing plan of reorganization which had been submitted the court for approval. The effect of the decision in that case was simply that a state court of equity may consider an existing plan of reorganization proposed by a bondholders' committee in deciding whether or not to grant its approval of a foreclosure sale. There is nothing in said decision which indicates that a minority bondholder may prevent a foreclosure sale by the alternative of an application to the court for a reorganization of the debtor. In the instant case there is no bondholders' committee and the Illinois Court lacks the power to compel Bishop to agree to a plan of reorganization in said foreclosure. Bishop owning two-thirds of the bonds can use his bonds in the bid at the foreclosure sale. Thus it can be seen that in a foreclosure proceeding a dominant bondholder is in a position to control said sale. As was said by the court in the case of *First National Bank* v. *Bryn Mawr Beach Bldg. Corp.*, 365 Ill. 409, 9 N. E. 2d 654 on page 426 in speaking of the advantages which a majority has over a minority in a foreclosure sale:

> "While ample notice of the sale was given yet it is but trite to say that anyone could bid who wished, for, as a court of equity cannot fail to recognize the advantageous position of the majority of the bondholders united, over the ununited minority who have not agreed to the reorganization plan, is such that, in the case of a very large property, unconscionable advantage may be taken of the latter."

As is evident from the record the instant foreclosure was not intended as a method of reorganization of the debtor (R. 31, 37), but is an attempt by Bishop to obtain a bargain purchase of the property at as cheap a price as possible.

The District Judge took judicial knowledge of the foreclosure laws of the State of Illinois in arriving at his finding of good faith and that under Section 146(4) he

could retain jurisdiction in the federal court if he found that the interest of creditors would be better subserved than in the prior proceeding. Even if there were a bona fide attempt to resort to the state court for the purpose of reorganization it would appear that in "substantial particulars" the state court could withhold or deny creditors the benefits, advantages or protection which Chapter X affords.

The inadequacies of the state court procedure as compared with the procedure under Chapter X are as follows:

1. In the instant case the exclusive right to foreclose the trust deed is vested in the indenture trustee, the bondholders are not necessary parties to the foreclosure proceeding, and are not parties either as plaintiff or defendant.

2. No notice of the filing of said foreclosure or of any of the steps in the proceeding were given nor had to be given to bondholders.

3. Bondholders do not have an absolute right of intervention in said foreclosure proceeding. As was said in the case of *American Trust & Safe Deposit Co.* v. *180 East Delaware Building Corp.*, 262 Ill. App. 67 (1931):

> "In view of the provisions of the trust deed as above set forth, it was not necessary to make any of the bondholders parties complainant or defendant to the bill. No bondholder has an absolute right of intervention, especially in the absence of any allegations of fraud, misfeasance or bad faith on the part of the trustee."

4. The fixing of an up-set price does not afford adequate protection to bondholders not a party to a plan of reorganization since it is discretionary whether the Illinois court will fix an up-set price and if it is fixed the standard is only that price which is not so grossly inadequate as to

shock the conscience of a court of equity. *Levy* v. *Broadway Carmen Bldg. Corp.*, 366 Ill. 279, 8 N. E. 2d 671 (1937).

5. The indenture trustee is in full control of the foreclosure proceedings and it is not subject to the wishes and desires of the bondholders.

6. The attorney for the indenture trustee need not be disinterested.

7. The court cannot compel the acceptance of a plan of reorganization nor to bind dissenters to a plan of reorganization.

8. No notice of the successive steps in the proceedings need be given to all the bondholders who are the only persons with a financial stake dependent upon the outcome of the foreclosure.

On the other hand Chapter X is far better equipped to supervise the reorganization procedure in the interests of all of the parties. The reorganization trustee and his attorney shall be disinterested (Section 156-8). Creditors receive notice of the hearing of the retention of the trustee. (Section 161), the filing of a plan by a trustee or any interested party, the date of hearing on the plan or any objections or amendments thereto (Sections 169, 170), the hearing for the consideration of said plan, and creditors alone vote on the acceptance of said plan if the debtor is insolvent (Section 179) as (Section 198) expressly limits the majority necessary for the acceptance of a plan to claims filed by the holders thereof and not by the indenture trustee. Before approving any plan the district court may seek the aid of the Securities and Exchange Commission for an advisory report. In addition the acceptance or failure to accept a plan under Chapter X must be made in "good faith" in order to be considered in determining the requisite majority for acceptance of the plan. Section 203. In the case of *Young* v. *Higbee Co.*, 324 U. S. 204 (1944) in a construction of said Section 203 on page 210:

> "If Potts and Boag had declined to accept this plan in bad faith the Court under Section 203 could have denied them the right to vote on the plan at all. The history of this provision makes clear that it was intended to apply to those stockholders whose selfish purpose was to obstruct a fair and feasible reorganization in the hope that someone would pay them more than the ratable equivalent of their proportionate part of the bankrupts assets."

By controlling each step of the proceeding every possible and conceivable safeguard has been provided by Congress for the protection of all parties to a Chapter X proceeding. An Illinois Equity Court does not afford minorities any such protection. A comparison of the procedure in the Illinois State Court and of Chapter X and the safeguard provided therein indicate glaring deficiencies in the State Court procedure.

B.

One of the considerations which moved the district court to retain jurisdiction was the dual position of Bishop as dominant creditor and who by reason of his employment by the indenture trustee as attorney in the foreclosure proceeding became a fiduciary and as such in control of the proceedings where with selfish motives he could be guilty of abuse. Seifried as the objecting creditor is a nominee of Bishop. It is admitted that Bishop advanced all of the funds for the purchase of the securities (R. 24, 32, 37). Bishop owns 66% of the bond issue.

It appears that the foreclosure proceedings were filed in the Illinois state court on December 2, 1944 (R. 29). The creditors' petition for reorganization was filed on December 9, 1944 (R. 2). The Section 210 affidavit filed by Seifried discloses that after the filing of the complaint in foreclosure Bishop bought bonds from his *cestuis*. He was then a fiduciary.

In discussing the duties and obligation of a trustee it was said in the case of *White* v. *McQueen*, 360 Ill. 236 on page 247:

> "* * * A trustee will not be allowed to place himself in such a position that he may not perform his duty to the mortgagor and owner of the equity of redemption, as well as to the bondholders to see that the property brings the greatest amount possible * * * It may exact from him the utmost fidelity and good faith and will not permit him to deal with the subject matter of the trust for his own benefit."

Thus it can be seen that the conduct of Bishop, who is a fiduciary is on a much higher level than that of persons dealing at arm's length with each other. *Meinhard* v. *Salmon*, 249 N. Y. 458, 164 N. E. 545 (1928). The facts in the instant case indicate that this is not a proceeding solely concerning the diverse interests of a majority bondholder and the minority bondholders. The majority bondholder by his own acts and conduct has caused himself to be saddled with the duties and obligations of a fiduciary. Why does Bishop, said fiduciary as well as objecting creditor resist so vigorously the jurisdiction of the federal court? A bankruptcy court being a court of equity may exact from him the utmost good faith and fidelity and will not permit him to deal with the subject matter of the trust for his own benefit. He can be called upon to account in the bankruptcy court in the reorganization proceedings for his purchases of securities from his *cestuis* and in the light of the circumstances the court may either disallow a portion of his claim so that he may not profit from said purchases or may subordinate a portion of said claim. *Pepper* v. *Litton*, 308 U. S. 295 (1939).

C.

We now come to a distinction of the instant case with that of *Marine Harbor Properties, Inc.* v. *Manufacturers*

Trust Co., 317 U. S. 78 (1942). The debtor's sole asset was an apartment building and it appeared the building was worth less than the senior indebtedness. The holders of the beneficial certificates were represented by a Schackno trustee. There was no equity in the assets for the junior creditors, and following unsuccessful attempts to reorganize under the state law, the bill of foreclosure was filed for the equal benefit of all members of the only class of creditors entitled to share in the proceeds. Shortly thereafter the debtor filed a voluntary petition under Chapter X and obtained an ex-party order approving the petition. The Schackno trustee then moved to vacate that order, dismiss the debtor's petition on the ground it was not filed in good faith. The opinion of the Supreme Court, after referring to the burden upon petitioner to "demonstrate that at least in some substantial particular the prior proceedings withhold and deny creditors or stockholders benefits, advantages or protection which Chapter X affords," first disposes of the interest of the equity owners who had instituted and supported the Chapter X proceeding. It was held that the debtor did not sustain the burden which federal statutes place on a petitioner, to show that so far as the "interests" of stockholders were concerned they would be denied in the State Court any benefits or advantages which Chapter X affords, as in either court the interest of stockholders would be extinguished, the debtor being insolvent.

The only portion of the opinion, therefore, which has any application to this case is that which deals with the interest of the first mortgage certificate holders. The court said on page 87:

> "There remains the contention that it was in the 'interests' of the certificate holders to have the proceedings transferred to Chapter X. In this connection much emphasis is placed on numerous safeguards contained in Chapter X * * * And it is asserted that

> comparative safeguards are wholly lacking in proceedings under the Schackno Act. These considerations would be highly relevant and persuasive if this was a case of the usual reorganization proceeding dealing with more than one class of securities under the older procedures which Chapter X was designed to improve and supplant * * * Then the safeguards offered by Chapter X would have special significance in protecting the respective classes of investors against improvident, unfair or inequitable adjustments, compromises and settlements—steps which are basic to the reorganization process but which in selfish hands led to much abuse."

In the *Marine Harbor* case as distinguished from the present case no conflict exists within the only class of creditors affected and the local foreclosure was not the result of a race between the diligent. In the instant case there is a conflict of interest between the creditors and the numerous safeguards contained in Chapter X become as highly significant and important as if there were more than one class of creditors. Bishop is a dominant creditor in a fiduciary capacity and in actual control of the foreclosure proceedings in the state court as opposed to the balance of the bondholders representing a substantial minority but not a party to said foreclosure proceeding. The Circuit Court of Appeals in this case has overlooked and has failed to give effect to that portion of the Marine Harbor Properties opinion which speaks of the safeguards which Chapter X affords where the steps in the reorganization are in the control of those persons who with selfish interests could be guilty of much abuse. Under circumstances where such persons are in control the interests of all creditors would not be best subserved in the prior proceedings, as defined in Section 146 (4) of Chapter X. The juxtaposition between the instant case and the *Marine Harbor* case is founded in the fact that in the *Marine Harbor* case there was no clash of interests or dispute between the only class

of creditors who could possibly be affected by either the reorganization or the foreclosure proceedings. Whereas in the instant case the contrary is precisely the situation for which relief is sought.

CONCLUSION.

We submit that the factors which warrant relief in this case are:

1. The opinion of the Circuit Court of Appeals for the Seventh Circuit misapplies the holding of this Court in the *Marine Harbor Properties, Inc.*, 317 U. S. 78 (1942).

2. The decision of the Circuit Court of Appeals if permitted to stand would bar petitions under Chapter X where a state court foreclosure proceeding is pending even though the state court proceedings are inadequate as compared to Chapter X, and a conflict exists between creditors.

WHEREFORE, it is earnestly urged that certiorari be granted by this Court, requiring the Circuit Court of Appeals for the Seventh Circuit to certify the record in this case to this Court for review and determination.

Respectfully submitted,

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In the Supreme Court of the United States

OCTOBER TERM, 1945

No. 250

IN THE MATTER OF SHERIDAN VIEW BUILDING CORPORATION, DEBTOR

CORNELIUS J. COLLINS, ET AL., PETITIONERS

v.

LESTER L. SEIFRIED

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE, IN SUPPORT OF THE PETITION

The Securities and Exchange Commission did not participate in the District Court proceedings in the present case but, with leave of court, appeared as *amicus curiae* in the appeal before the Circuit Court of Appeals for the Seventh Circuit. It submits this memorandum as *amicus curiae* in support of the instant petition for a writ of certiorari filed by minority bondholders of the debtor.

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 116–119) is reported at 149 F. 2d 532. The District Court filed no opinion but entered a written order approving the petition for reorganization as having been filed in good faith (R. 16–21).

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 6, 1945 (R. 120). The petition for a writ of certiorari was filed on July 21, 1945. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925, 28 U. S. C. 347 (a).

QUESTION PRESENTED

Whether a Chapter X reorganization proceeding must be dismissed in favor of a recently instituted prior proceeding affecting the Debtor because it appears that a single class of creditors is entitled to a preponderant interest in the Debtor's assets, despite a clash of interests within the class and indications that the situation presented is fraught with the possibility of inequitable conduct operating to the detriment of unorganized security holders.

STATUTES INVOLVED

The following sections of Chapter X of the Bankruptcy Act provide:

Section 130, 11 U. S. C. 530:

> Every petition shall state * * * (5) the nature of all pending proceedings affecting the property of the corporation known to the petitioner or petitioners and the courts in which they are pending; * * * (7) the specific facts showing the need for relief under this chapter and why adequate relief cannot be obtained under chapter XI of this Act; * * *

Section 144, 11 U. S. C. 544:

> If an answer filed by any creditor, indenture trustee, or stockholder shall controvert any of the material allegations of the petition, the judge shall, as soon as may be, determine, without the intervention of a jury, the issues presented by the pleadings and enter an order approving the petition, if satisfied that it complies with the requirements of this chapter and has been filed in good faith and that the material allegations are sustained by the proofs, or dismissing it if not so satisfied.

Section 146, 11 U. S. C. 546:

> Without limiting the generality of the meaning of the term "good faith" a petition shall be deemed not to be filed in good faith if * * * (4) a prior proceeding is pending in any court and it appears that the interests of creditors and stockholders would be best subserved in such prior proceeding.

Section 256, 11 U. S. C. 656:

> A petition may be filed under this chapter notwithstanding the pendency of a prior mortgage foreclosure, equity, or other proceeding in a court of the United States or of any State in which a receiver or trustee of all or any part of the property of a debtor has been appointed or for whose appointment an application has been made.

STATEMENT

The litigants hold interests in the Debtor's principal bond issue—an issue of second mortgage bonds of which $200,800 were outstanding on December 1, 1944, the date of maturity. This issue is now in default. A first mortgage debt of $26,000 is also outstanding, but is not in default. The sole asset of the debtor is an apartment building in Chicago, Illinois. The bondholders are also the owners of all of the Debtor's capital stock as a result of a prior local reorganization under which stock holdings were attached to bond ownership, and pursuant to which a proportionate interest in the stock passes with a transfer of bonds. (R. 3, 10, 11, 26.)

The bonds presently in default were issued pursuant to a trust indenture naming The Trust Company of Chicago as trustee and empowering holders of 51% of the outstanding bonds to direct and control the acts of the trustee and to remove the latter at their pleasure (R. 25, 86).

Under the indenture the Debtor waived all rights of redemption in the event of a foreclosure sale (R. 30).

In his statement under Section 210 of the Bankruptcy Act (11 U. S. C. 610), respondent Seifried, who opposed the Chapter X petition for reorganization, listed himself as the owner of $132,800 of the second mortgage bonds which he had acquired between October 9, 1944, and December 19, 1944, and which is 66.1% of the outstanding issue (R. 13–14). It appears, however, that one Howard F. Bishop, a Chicago attorney, actually furnished the money with which Seifried purchased these bonds and apparently is the real owner of these securities (R. 23–26, 32, 47). The average purchase price was $68 as against a par value of $100 (R. 32).

On December 2, 1944, the day following maturity and default on the bonds, Bishop having then acquired more than 51% of the outstanding bonds and also having a controlling interest in the stock, called upon an officer of the corporate indenture trustee with a prepared bill of foreclosure and, purporting to act as Seifried's attorney only, requested and obtained the proper execution of the bill and arranged for the employment of his own law firm as attorney for the indenture trustee in the foreclosure proceeding (R. 27–29, 35–38). Immediately thereafter, the bill of foreclosure was filed in the Superior

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Court of Cook County, Illinois, to which the only parties were the indenture trustee, as plaintiff, and the Debtor, as defendant. No notice was given any of the other bondholders and apparently none was required under state law since, under the indenture, these bondholders were not necessary parties to the foreclosure proceeding.

Several days later, on December 9, 1944, petitioners, minority holders of $5,700 of the second mortgage bonds, filed a creditors' petition under Chapter X, noting *inter alia* the pendency of the local bill of foreclosure but alleging with respect to the foreclosure proceeding that increased real estate taxes, increased operating and labor costs, and O. P. A. rent ceilings made it improbable that a fair price for the Debtor's apartment building could be obtained at the foreclosure sale and that the sale would result in great loss to bondholders and to the Debtor. Relief accordingly was sought in a Chapter X reorganization modifying and altering the rights of the secured creditors. (R. 2–8.) Thereupon Seifried filed an answer attacking the "good faith" of the petition, challenging the possibility of reorganization, and alleging that the bondholders were adequately protected by the state court proceedings (R. 9–12). At the hearing on the "good faith" issue, it appeared that Seifried and Bishop had not resorted to the state court foreclosure pursuant to any program for reorganization or otherwise in furtherance of the interests of the bondholders

as a whole (R. 31, 37), but were relying on their rights under the indenture as majority holders to direct the action of the trustee. Under the indenture, they would be in a position to apply their bonds in payment of the purchase price and secure title free from any possibility of redemption by the Debtor (R. 43, 73). No opposition to the foreclosure was offered by the debtor. Seifried and his "attorney," Bishop, had been associates in a number of real estate ventures (R. 46 *et seq.*) and it is not an unwarranted inference that they desired to use their recently acquired bonds either to acquire the property for themselves as cheaply as possible or to effect a sale to a third party under some prior arrangement, and that their self-interest conflicted with that of other bondholders.

At the hearing respondent offered in evidence an appraisal by the Chicago Real Estate Board, dated December 22, 1944, estimating the fair market value of the Debtor's property at $171,000, which is $55,800 less than the first- and second-mortgage indebtedness (R. 47, 74–84). Petitioners objected to its relevancy and were sustained by the court.

The District Judge entered an order on January 5, 1945, approving the petition as having been filed in "good faith," and appointing a trustee for the Debtor and its property (R. 16–21). Thereupon Seifried appealed to the Circuit Court of Appeals for the Seventh Circuit. On June 6,

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1945, that court reversed the order of the District Judge on the ground that petitioners had not established the inadequacy of the state foreclosure proceedings for the protection of their interests and that no "need for relief" existed under Chapter X, noting from the excluded appraisal report the probable lack of any equity in the property beyond the interests of the mortgage bondholders. The present petition for a writ of certiorari followed.

ARGUMENT

I

The issue presented is of substantial importance. Under the construction of Section 146 (4) of the Bankruptcy Act, 11 U. S. C. 546 (4), adopted by the Circuit Court of Appeals in the instant case, the right to reorganization under Chapter X has been made to depend on the outcome of a race of diligence in cases involving corporations with simple debt structures in which a senior class of creditors is alone possessed of any equity in the principal assets of the debtor.

Corporate reorganizations of this type are common, particularly in the real estate field, where a need often exists to accord the benefits of Chapter X procedures to widely scattered public investors.[1] The instant holding, in effect, *pro tanto*

[1] In the late 'twenties certificates of fractional interest in real estate mortgages upon apartment houses, office

repeals the provision of the Bankruptcy Act which expressly states that a petition may be filed under Chapter X notwithstanding the pendency of a prior proceeding (Section 256, 11 U. S. C. 656), although Section 146 (4) provides for the dismissal of a Chapter X petition on account of a prior pending proceeding only where the interests of creditors and stockholders would be "best subserved" in the prior proceeding.

The Circuit Court of Appeals for the Third Circuit has also adopted this view of Section 146 (4) in its recent decision in *In re St. Charles Hotel Company,* 149 F. 2d 645, affirming on opinion of the District Court, 60 F. Supp. 322 (D. N. J.) petition for certiorari filed July 27, 1945. The Commission is filing a companion brief supporting the

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buildings and hotels were widely distributed among a class of investors who did not foresee the difficulties of enforcing their claims in the event of default. The plight of such investors was one of the major scandals in the reorganization field and became the subject of investigation by Federal and state legislative committees and by the Securities and Exchange Commission. See *Hearings before the Select Committee on Investigation of Real Estate Bondholders' Reorganizations, House of Representatives* (1934–1936); *Hearings before the Joint Legislative Committee to Investigate Legal Investments for Savings Banks, et al.* (N. Y. 1933); *Report of the Joint Legislative Committee to Investigate Bondholders' Committees, et al.* (N. Y. 1936); *S. E. C. Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees, Part III, Committees for the Holders of Real Estate Bonds* (1936).

While that portion of the Commission's Report which dealt with committees for the holders of real estate bonds

petition for certiorari in that case,[2] to which the Court is respectfully referred.

The effect of these circuit court decisions has been to deny invocation of the paramount Federal bankruptcy power in favor of the prior state court proceedings, despite their inadequacy judged

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concerned itself primarily with misuse of the reorganization process by the house of issue, it was incidentally revealed that in the real estate field investors' holdings were "unusually small and the holders exceptionally dispersed" (S. E. C. *Report*, *supra*, Pt. 3, p. 29), making the holders unusually helpless in the face of the superior facilities for organization of those affiliated with the house of issue. We believe that comparable opportunities for prejudice to the scattered holders of real estate bonds may exist even where the house of issue does not happen to be the focal point of reorganization maneuvers. Congress took specific cognizance of the need for the exercise of the bankruptcy powers in this field of reorganization—e. g., Chapter XII, designed to reach situations, particularly in the Chicago Metropolitan area, where the debtor happened to be an individual rather than a corporation (See H. Rep. 1409, 75th Cong. 1st sess., p. 51); Sections 256 and 131 (4) of Chapter X, broadening the scope of the corporate reorganization provisions to reach cases in which a petition might be predicated on a mortgage foreclosure receivership to which this Court had held Section 77B inapplicable in *Duparquet, Huot & Moneuse Co.* v. *Evans*, 297 U. S. 216; and Section 126, broadening the class of persons entitled to file an involuntary petition to include holders of claims against the property of a debtor as well as persons holding claims against the debtor. This was stated to be relevant chiefly to the real estate situation where debtors may purchase property subject to, but without assuming liability on, a mortgage. S. Rep. 1916, 75th Cong., 3d sess., p. 21. See *Brooklyn Trust Company* v. *R. A. Security Holdings, Inc.*, 134 F. 2d 164 (C. C. A. 2).

[2] *Ladin* v. *Hurwith*, No. 264, this Term.

by Chapter X standards and the existence of circumstances which point strongly to a need for the protections and advantages afforded by Chapter X machinery. The circuit courts have made unjustified assumptions as to the adequacy of the older foreclosure and receivership procedures which Chapter X was intended to supplant, and have imposed upon the petitioner the impossible burden of establishing in each case that harmful or inequitable consequences would necessarily result in the prior proceeding, instead of permitting reliance upon facts which are relevant to the legislative determination as to when Chapter X proceedings may be invoked. No effort has been made in these cases to determine whether, in light of the existing conflict among creditors as revealed by the race to institute the proceedings and other circumstances indicating the potentiality of abuse, the prior proceeding would actually "best subserve" the interests of creditors and others affected. On the contrary, the courts have been content with determining that junior interests have no equity in the sole or principal assets of the debtor and have held such cases to be proper ones for the relinquishment of Federal jurisdiction under the purported authority of the decision of this Court in *Marine Harbor Properties, Inc.* v. *Manufacturers Trust Co.*, 317 U. S. 78.

As we show below (pp. 15–16), the burden which the *Marine Harbor* case holds to be on the petitioner is one which this Court recognized might

be met by showing the kind of clash of interests and opportunity for abuse which makes relevant the superior safeguards of Chapter X. The Circuit Courts of Appeals for the Third and Seventh Circuits, however, have appeared to treat as a rule of thumb the particular illustration of a conflict of interests justifying resort to Chapter X proceedings, which was adverted to by this Court. The Court's reference to "the usual reorganization proceeding dealing with more than one class of securities under the older procedures which Ch. X was designed to improve and supplant" (317 U. S. at 87) is thus regarded by the two Circuits as an all-inclusive determination that prior proceedings are to take precedence where only one class of securities is predominantly affected. We believe that the result is the application as a governing principle of a statement which this court intended merely as an illustration of the type of cases in which a clash of interests is normally found. The consequence is virtually to preclude the availability of Chapter X where only a single class of creditors is substantially interested, even though the priority of the competing proceeding is a matter of days and results from a race of diligence which only emphasizes the clash of interests within the single class of creditors affected. As a consequence of these circuit court holdings there is a real need for further definition and clarification by this Court of the term "good faith" as it appears in Section

146 (4) of the Bankruptcy Act. Otherwise, the benefits of Chapter X will in practice be rendered unavailable to a substantial class of creditors and corporate debtors, contrary to the true intendment of the statute.

The *Marine Harbor* case upon which the circuit courts have relied is not authority for the rulings made. That case did hold that Section 146 (4) must be read together with Section 130 (7) as imposing upon the petitioner the necessity to "demonstrate that at least in some substantial particular the prior proceedings withhold or deny creditors or stockholders benefits, advantages, or protection which Ch. X affords" (317 U. S. at 84). Thereby this Court rejected a narrower construction of the statute under which, if the appropriateness of a Chapter X petition is in other respects established, it may supplant the prior proceeding only if it is demonstrated that the interest of security holders will not be best subserved in the prior proceeding.[3] In that case the senior credi-

[3] The majority of the Circuit Court of Appeals had assumed without discussion that the Chapter X procedure would best subserve the interest of creditors, but found that in other respects the good faith standard was not met. Frank, J., dissenting, had intimated that the burden on those seeking to dismiss the Chapter X proceeding required a demonstration that the state court procedure would result in the parties being protected by safeguards substantially equivalent to those of Chapter X and that this might require that the state court proceeding had progressed to the point where a plan had been proposed, which on examination by the federal court appeared "fair and equitable" and "feasible." See 125 F. 2d 296, at p. 303.

tors (who alone had an equity) were holders of certificates of participation in a first mortgage. They were represented in the state court action (which had been of substantial duration) by an independent trustee under the New York Schackno Act who was empowered to take title to the mortgaged property on behalf of the entire class of security holders affected. There was no conflict among these security holders as to the preferability of the state proceedings and it appeared that the presumptive result of those proceedings would be, by foreclosure, "an appropriation of the assets of the debtor for the benefit of the certificate holders exclusively" (317 U. S. at 87). Irrespective of the general superiority of Chapter X machinery as a vehicle for reorganization, therefore, this Court held the petitioner had not met the burden upon him because, among other reasons, there was in this instance "no showing that the machinery employed or available in the state foreclosure proceeding to safeguard and protect the interests of those creditors *after* the sale is not comparable to that contained in Ch. X for the consummation of plans which are not only fair but feasible." It was in this context that the Court concluded:

> In view of the burden on a petitioner to make the showing required by § 130 (7) and § 146 (4), the bankruptcy court is not warranted in assuming, without more, that a state foreclosure proceeding instituted

> for and on behalf of the first mortgage creditors exclusively, is inadequate, measured by Ch. X standards, to protect their interests. The contrary course would result in Ch. X making greater inroads on prior proceedings than § 130 (7) and § 146 (4) indicate was the purpose. [317 U. S. at 88.]

In rejecting a construction which might leave very little room for the continuation of prior proceedings, the Court nevertheless recognized that a normal and expressly sanctioned purpose of the filing of petitions under Chapter X was the displacement of prior proceedings as is indicated by Section 256.[4] The Court also indicated that the Chapter X petitioner may meet the burden imposed upon him if he can show the existence of a clash of interests which the Chapter X safeguards are peculiarly adapted to resolve—e. g., to protect scattered investors against the power

[4] The Court's reference to Section 256 occurs in that portion of the opinion wherein it rejected a holding of a majority of the court below that prior participation in the state court proceedings would impose a personal disqualification on the petitioner irrespective of the interests of creditors and stockholders. The Court stated that this "would effect a substantial impairment of § 146 (4), since it would be the exception rather than the rule where both the debtor and the creditors had not taken some part in the prior proceedings" (317 U. S. at 85). We believe the same consideration equally applicable to any argument which would make the existence of the prior proceeding an automatic bar to a filing in good faith of a petition under Chapter X.

of those in a dominant strategic position with reference to the foreclosure or judicial sale, which was the critical point "under the older procedures which Ch. X was designed to improve and supplant." The illustration which this Court gave was a reorganization proceeding which deals with more than one class of securities where "the safeguards afforded by Ch. X would have special significance in protecting the respective classes of investors against improvident, unfair or inequitable adjustments, compromises, and settlements—steps which are basic to the reorganization process but which in selfish hands led to much abuse." (317 U. S. at 87.) We believe, however, that this was not intended as an all-inclusive statement of situations in which Chapter X might displace the prior proceeding.

The instant case and the *St. Charles* case (*supra*, p. 9) deal with situations in which only a single class appears to have a substantial interest in the proceeding.[8] Nevertheless, in each case the clash of interests among the members of that class presents opportunities for questionable maneuvers in connection with a judicial sale, not less harmful than those in the case of a reorganization which affects a number of classes. In each case the proceeding appears to be moving toward a sale in which the interest of the dom-

[8] The existence of substantial free assets presents an additional problem in the *St. Charles* case.

inant group may prevail over that of the scattered minority bondholders.[6] While the equitable jurisdiction of the state courts may afford safeguards against gross abuse in foreclosure suits, their powers are no greater than those in an equity receivership proceeding, the traditional inadequacies of which led to the bankruptcy reorganization statutes. H. Rep. No. 1409, 75th Cong., 1st Sess., p. 37 *et seq.*; *Securities and Exchange Commission* v. *United States Realty & Improvement Co.*, 310 U. S. 434, 448–450. This legislative background of Chapter X was completely overlooked by the court below, in its assumptions as to the adequacy of the state court procedure.

The *Marine Harbor* decision, dealing as it did with state court proceedings of substantial previous duration, did not consider situations in which the priority in point of time in the earlier proceedings is slight, resulting simply from a race of diligence. In such a case, the petitioner should be able to meet his burden of establishing good faith by showing that the type of reorganization problem presented is one which makes relevant

[6] The probability that the successful purchaser at the sale will be a person or group in a position to fullfill his bid in large part by tendering bonds affords the potentiality of abuse towards which Chapter X safeguards were directed. Although that evil was most frequently manifested in instances where the dominant group combined with equity interests in an unfair plan, it would, we believe, be an unduly narrow construction to limit the availability of Chapter X to instances where such combination, actual or potential, is established.

the superior safeguards of Chapter X. And, if priority in point of time is not to be the sole test, it would be undesirable to require that the prior proceedings shall continue to the point where the inadequacies which induced Congress to provide for reorganization under the Bankuptcy Act have been specifically demonstrated (such as an unfair plan upon the point of consummation). If it were necessary thus to await developments in the state court proceedings, the loss of time incident to beginning over again under Chapter X and the accumulation of expense in the state court proceeding might, at the later stage, offset the superiority of the Chapter X procedure. In such a case we believe that the statute calls for a realistic appraisal of the potentialities of the two proceedings in the light of traditional inadequacies and abuses of the older procedures and of the safeguards of Chapter X.[7] This approach was rejected by the court below.

[7] Among these safeguards we advert particularly to the provision for an independent trustee, who is not a mere stakeholder but has definite reorganization responsibilities as a "focal point" for investor organization (Sec. 167, 11 U. S. C. sec. 567); the power to bind dissenters and to dispense with the cumbersome machinery of judicial sale and the necessity of paying dissenters in cash; and the affirmative responsibility of the Court to find the plan fair, equitable and feasible as distinguished from the tendency of receivership courts to concern themselves only with grossly inequitable results. As applied to the smaller proceedings, such as that involved in the instant case, we do not emphasize the advisory functions of the Commission. In the instant case the Commission was

Review by this Court is necessary to correct a substantial inroad upon the availability of Chapter X, contrary, we believe, to the proper interpretation of the statute and of this Court's decision in the *Marine Harbor* case.

II

The instant case involved a clash of interests between the majority and minority bondholders of the very type which should have compelled the court to weigh the relative advantages and particular benefits of Chapter X as against "the older procedures which Ch. X was designed to improve and supplant" (317 U. S. at 87). Seifried and Bishop were associates in other real estate ventures and their apparent purpose in precipitously instituting the local foreclosure was to obtain a bargain purchase of the debtor's apartment building. Their self-interest conflicted seriously with that of the other bondholders. The state court action afforded the minority bondholders very little protection against the danger of being squeezed out of the enterprise with inadequate compensation. The price obtainable at the foreclosure sale probably would have been inadequate, since it is apparent that a fair price for an apartment building ordinarily can be secured only after a search for a suitable purchaser and arm's length bargaining, and not on the auction block.

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not a party in the District Court and advised the court below that it would not seek to intervene if the jurisdiction of the bankruptcy court should be sustained.

The Circuit Court of Appeals referred, however, to the general equity power of the local court "to see to it that one creditor does not receive an undue advantage of another," and to its more specific power to refuse approval to a foreclosure sale in the event of unfairness (R. 118–119), citing *Levy* v. *Broadway-Carmen Building Corporation,* 366 Ill. 279, 8 N. E. 2d 671 (1937). In addition, the circuit court noted that the local court, in the exercise of its general equity powers, could "where the interests of a number of bondholders are involved, consider an intervening petition proposing a plan by and for the protection of the bondholder," citing *First National Bank* v. *Bryn Mawr Beach Building Corporation,* 365 Ill. 409, 6 N. E. 2d 654 (1937) (R. 119).

The circuit court's view of the Illinois law, however, is a very optimistic one and apparently much more advanced than that of the state court itself. In the *Bryn Mawr* case, a bid at a master's sale was made by a representative of a bondholders' committee pursuant to an existing plan of reorganization. The holding of the state supreme court is simply that the equity court could properly consider the existing plan of reorganization in deciding whether or not to approve the sale to the bondholders' committee. There was no holding that a minority bondholder may prevent a foreclosure sale by the alternative of an application to the court for a reorganization of the

debtor in the foreclosure proceedings. In the *Levy* case the Illinois court took cognizance of the discretionary power of the foreclosure court to fix an "upset price," but recognized that this price may merely be one which is not so grossly inadequate as to shock the conscience of the court (366 Ill. 288).

In addition, the Circuit Court of Appeals ignored the nature of foreclosure practice in situations such as that in the instant case, where the foreclosure was instituted by an indenture trustee wholly subject to the control of a majority bondholder and where opposition by the debtor and other bondholders was effectively stifled. Minority bondholders received no notice of the filing of the bill and none apparently was required under state law since, under the indenture, the exclusive right of action vested in the indenture trustee. The bondholders, not being necessary parties, had no absolute right of intervention. See *Firebaugh* v. *Traff*, 353 Ill. 82, 186 N. E. 526 (1933); *American Trust & Safe Co.* v. *180 East Delaware Building Corp.*, 262 Ill. App. 67 (1931). The majority bondholder not only directed the action of the indenture trustee but also represented the latter as its attorney in the foreclosure proceeding. Moreover, since this majority bondholder held also a controlling interest in the capital stock of the debtor, no opposition was forthcoming from the latter. Had the local proceeding

been uninterrupted, it is improbable that there would have been any other result than a sale to the highest bidder. The property probably would have been bid in by the respondent who, under the indenture, was in a position to apply his bonds toward the purchase price and secure title free from any possibility of redemption by the debtor. In the event of a denial of the instant petition for certiorari, this will be the probable result.

Under these circumstances, resort to the Chapter X machinery was necessary for the protection of the other bondholders. A Chapter X court would provide an independent and disinterested trustee (Section 156, 11 U. S. C. 556) whose duties would include the formulation of a fair, equitable, and feasible plan (Section 169, 11 U. S. C. 569). The attorney for the reorganization trustee would also be disinterested (Section 157, 11 U. S. C. 557). All bondholders would be notified of the ocurrence of such steps as hearings on the qualifications of the trustee (Section 161, 162, 11 U. S. C. 561, 562), the filing of a plan of reorganization (Section 169, 171, 11 U. S. C. 569, 571), and the like. Under Chapter X, the majority bondholder cannot use the indenture trustee to control the conduct of the proceedings. Votes not cast in "good faith" would be eliminated (Section 203, 11 U. S. C. 603). Upon court confirmation, the plan would be binding upon dissenters (Section 224, 11 U. S. C. 624).

Among other alternatives, a Chapter X reorganization could take the form of an extension of the debt or a reduction of the interest rate or of the principal of the mortgage indebtedness to the point where no undue burden would be placed upon the earning capacity of the debtor. Through its disinterested trustee, the Chapter X court could obtain informed and independent advice as to the type of plan best adapted to serve the interests of all the creditors, including the possibility of sale to a satisfactory purchaser dependent upon an arm's length bid of an adequate price.

We submit that a proper application of the statute and the rationale of this Court in the *Marine Harbor* case required an affirmance by the court below of the District Judge's approval of the Chapter X petition as having been filed in "good faith."[8]

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[8] In reversing the District Judge's order of approval, the Circuit Court of Appeals also noted that the petition "did not allege the specific facts showing the need for relief and that it was reasonable to suppose that a plan of reorganization could be effected, nor was there any proof tending to establish such facts" (R. 119). As to the lack of proof, the circuit court complained of the absence of "any evidence of the debtor's financial history, [and] its earning capacity, past, present, or prospective" (*ibid*). The Commission was not a party in the District Court proceedings and did not participate in the development of the record. However, where the proof is sufficient to satisfy the District Judge as to the "good faith" of the petition (see Section 144, 11 U. S. C. 544), the circuit court is not justified in requiring dismissal of the peti-

CONCLUSION

By virtue of the foregoing, it is respectfully submitted that the petition for a writ of certiorari should be granted.

HAROLD JUDSON,
Acting Solicitor General.

ROGER S. FOSTER,
Solicitor,
Securities and Exchange Commission.

AUGUST 1945.

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tion, as the opinion and order of reversal here appear to do. Rather, if the court below deemed insufficient the evidence which satisfied the reorganization judge, it should have remanded the case to the lower court for the taking of further proof and for further consideration of the whole record. However, as the matter stood, since the Circuit Court had already assumed the adequacy of the prior state foreclosure proceeding under its own construction of the *Marine Harbor* case, further inquiry upon remand with regard to a reorganization was apparently useless.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 250

CORNELIUS J. COLLINS, et al.,
Petitioners,

vs.

LESTER L. SEIFRIED,
Respondent.

SHERIDAN VIEW BUILDING CORPORATION,
Debtor.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF IN OPPOSITION THERETO.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1945.

No. 250

CORNELIUS J. COLLINS, et al.,
Petitioners,

vs.

LESTER L. SEIFRIED,
Respondent.

SHERIDAN VIEW BUILDING CORPORATION,
Debtor.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF IN OPPOSITION THERETO.

To The Honorable, The Chief Justice And Associate Justices Of The Supreme Court Of The United States:

Counsel for Respondent, Lester L. Seifried, respectfully show this Court the following reasons why a Writ of Certiorari should not be issued to the United States Circuit

Court of Appeals for the Seventh Circuit to review an order of that Court entered on June 6, 1945, reversing an order of the United States District Court for the Northern District of Illinois, Eastern Division, entered January 5, 1945.

No ground for Certiorari under Rule 38.

Introductory. The issue before this Court on the Petition for Certiorari is very simple. We do not think the Petitioners or counsel for the Securities and Exchange Commission have come within the requirements of Rule 38 (5) on the subject of certiorari. No "special and important reasons," Rule 38 (5), have been suggested, and none can be, for none exist; and the Circuit Court of Appeals did not decide a "federal question in a way probably in conflict with applicable decisions of this Court," Rule 38 (5) (b).

The Circuit Court of Appeals held against the Petitioners because they failed to observe or comply with certain elementary requirements of pleading and proof under Chapter X of the bankruptcy act. The grounds of the decision are clearly and concisely stated by Judge Kerner, as follows:

> "In the case before us the petition did not allege the specific facts showing the need for relief and that it was reasonable to suppose that a plan of reorganization could be effected, nor was there any proof tending to establish such facts. The court was not warranted in assuming without more that the state foreclosure proceeding was inadequate to protect petitioners' interests. *Marine Harbor Properties, Inc.* v. *Manufactureers Trust Co., supra,* 88. Neither was there any evidence of the debtor's financial history, its earning capacity, past, present, or prospective, and when appellant offered to prove that the fair market value of

the property was $171,000, that is, $55,800 less than the first and junior indebtedness, appellee objected and the court sustained the objection."

It is respectfully submitted that the rules stated by the Circuit Court of Appeals as the basis for its holding are universally accepted as correct in all circuits and in this Court. *Marine Harbor Properties, Inc.* v. *Manufacturers Trust Co.*, 317 U. S. 78, 86; *Fidelity Assurance Association* v. *Sims*, 318 U. S. 608; *In re Western Tool Mfg. Co.* (1944), 142 Fed. (2d) 404.

The Court said in the *Marine Properties* case that the "Burden (rests on the petitioner to make the showing required by Section 130 (7) and Section 146 (4)" of the bankruptcy act and that the District Court was not warranted "in assuming" the existence of facts which Congress required to be shown before the Court will retain jurisdiction under Chapter X, over the objection of creditors duly and properly interposed. This burden the Petitioners, as pointed out by Judge Kerner, did not even attempt to discharge either by suitable pleadings or competent proof. This proof on their part requires a dismissal of the Petition *in any Court.*

While we believe the absence of merit in the Petition for the writ is so obvious that we would be justified in ending our brief in oppostion here, we do not wish to seem disrespectful of counsel for the Petitioners or the Commission and their presentation by ignoring their argument in too summary a fashion. We shall, therefore, analyze and briefly comment upon the Petition and the supporting memoranda filed by counsel for the Petitioners and for the Commission.

BRIEF IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

I. Reply to Petitioner's Brief.

1. *Question Misstated by Counsel*

Two Briefs or Memoranda have been served in this proceeding, one by Petitioners, which is printed, and another in typwritten form by the Securities and Exchange Commission as *Amicus Curiae* in support of the Petition for the Writ. For brevity and convenience we shall refer to the memorandum we are discussing as "Petitioners' " or "Commission," respectively. The pagination of the printed and typed copies of the Commission Memorandum may not correspond. Our page references to the Commission's Memorandum are necessarily to the typed copy.

We think the Petitioners and the Commission erroneously state the question before the Circuit Court of Appeals. In the statement of the question on p. 2, the Commission says that the question is whether

> "a Chapter X Bankruptcy Proceeding must be dismissed in favor of a recently instituted prior proceeding affecting the debtor * * *"

Petitioners on p. 2 state the question in substantially the same narrow and erroneous form. As stated by the parties, the impression is conveyed that the *only* question before the Circuit Court and the District Court was whether a "prior proceeding" adequately protected the interests of all creditors. Such was not the case. On p. 2 of this brief we have quoted from the opinion of Judge Kerner

of the Circuit Court of Appeals the grounds on which the decision of that Court was made. It there appears that that Court reversed the District Court because the petition for reorganization did not allege specific facts showing need for relief and that it was reasonable to suppose that a plan of reorganization could be effected, nor did the Petitioners offer any proof tending to establish such facts. The Court also held that the District Court was not warranted in assuming without proof that the state foreclosure proceeding was not adequate to protect Petitioners' interests. It is obvious, therefore, that the District Court was reversed because, as we state on p. 15 of this brief, the Petitioners failed to comply with certain elementary requirements of pleading and proof under Chapter X of the Bankruptcy Act, recognized as binding in all courts.

Moreover, the Commission indulges in a strange, because wholly indefensible, assumption of fact. In the purported statement of the question before the Court, the Commission *assumes* a clash of interests "within the class and indication that the particular reorganization" may be inequitable. There are two gratuitous assumptions involved in this statement: one, that there is a clash of interests, which is not correct; and secondly, that there was a "particular reorgonization" before the District Court or before the Circuit Court, which is not true. No plan of reorganization was even suggested in the District Court, and of course not in the Circuit Court; there was not even a hint in the testimony or in the Petition in the District Court that a reorganization was possible. The entire argument of both parties which follows is addressed to and based on this materially incorrect statement of the question before the Court.

2. *Petitioners' Statement*

In most essential particulars, the statement in the brief of the Commission is open to the same criticism for inaccuracy and omission of material matters as is the statement of counsel for the Petitioners. In one respect, however, the brief of the Commission differs in the statement from that of the Petitioners, namely, the Commission has abandoned its colleagues, counsel for the Petitioners, on the point that the Respondents, Seifried and his co-owner of the bonds, Howard F. Bishop, are fiduciaries. Obviously the point was and is wholly without merit.

3. *"Reasons for Granting the Writ"*

On pp. 8-9 Petitioners set forth the reasons why they think a writ should be granted. These reasons, as expressed or implied, may be summarized under the following points.

(a). Although an indenture truste may act to forclose in behalf of all bondholders in order to protect their interest, under an indenture securing all bonds of a certain issue without discrimination, where bondholders are not given notice of such proceeding to foreclose, such security holders are *prima facie* not adequately represented by the indenture trustee, where each bondholder or any group of bondholders do not "have an absolute right of intervention." p. 8.

Reply. The claim that "minority" bondholders had no notice of the state court proceeding and were not represented is without the slighest merit on the facts, for they were in fact and in law represented by the indenture trustee, and had notice through the indenture trustee which

acted for them. Against this trustee no hint of fraud has been offered. In *Shaw* v. *Railroad Co.*, 100 U. S. 605, at p. 612, the Court said:

> "The trustee represents the mortgage, and in executing his trust may exercise his own discretion within the scope of his powers. If there are differences of opinion among the bondholders as to what their interests require, it is not improper that he should be governed by the voice of the majority acting in good faith and without collusion, if what they ask is not inconsistent with the provisions of the trust."

Not only was the request that the trustee commence foreclosure proceedings consistent with the terms of the trust, but it was expressly stipulated that 51% of the bondholders could direct the commencement of such proceedings. Speaking of notice, the majority bondholders were given no notice of proceedings under Chapter X.

(b) Where a group of such bondholders as have been described in (a) above, holding not over $5700, or less than 2½%, of the issue secured, proceed, or let themselves be persuaded to proceed, under Chapter X in the District Court, "a conflict exists between bondholders."

Reply. It seems to be suggested that since three bondholders could be persuaded to file a petition under Chapter X, there is some sort of a "conflict" and the decision in *Marine Harbor Properties, Inc.* v. *Manufacturer's Trust Co.* does not apply. The reasoning in support of this proposition is involved and obscure, but it leads unavoidably to the result that in *every* case where three creditors with sufficient claims file a petition under Chapter X against a debtor which has pending against it a proceeding in another court, these creditors somehow become privileged under the law and do not need to bear the normal burden of pleading and proof in a Chapter X proceeding. They do not, it seems, have the burden to show the

usual statutory grounds for taking and retaining jurisdiction, such as reasonable possibility of successful reorganization [Secs. 130, 146 (3)] and that the pending state proceeding will not adequately protect creditors [Sec. 146 (4)]. There is no such law, rule or doctrine, and the notion is exactly the contrary of what the courts have held and Congress intended. The requirement of good faith in Chapter X cannot be brushed aside merely because creditors are not unanimous in their views on the best forum or procedure.

(c) Mr. Bishop is called a "dominant bondholder"—he with Seifried held 66% of the bonds—and it is said that he "was a fiduciary, and as such, his personal interest was antagonistic to the interest of minority bondholders"; the "fiduciary" character of Mr. Bishop's position seems to arise from the fact that he and Mr. Seifried became majority bondholders and thus, as it is hinted, displaced the true fiduciary, the indenture trustee. P. 8.

Reply. This is a non-sequitur, for just because two persons—Mr. Bishop and the respondent—become majority holders does not give rise to "antagonistic" interest, unless as a matter of law the majority is always in antagonism with the minority. This is absurd, of course, and no court has ever so held when, as here, an indenture trustee stands indifferently the representative of *all* security holders. Mr. Bishop is no more a fiduciary than any majority potentially is. Plainly the majority of *shareholders,* with voting and policy making powers, may find themselves in the position of a fiduciary, but not so here where all *bondholders* are protected by one instrument and the trustee is bound by contract, by equitable principles and by common morality to act impartially for all, singly

and collectively. The statement of this Court in *Shaw* v. *Railroad Co.*, 100 U. S. 605, 612, quoted above, negatives this contention completely. The fiduciary here was the trustee, and he was not, could not be, and it is not claimed that he was displaced as such fiduciary by a bondholder or by bondholders.

(d) The majority of the bondholders had the right to remove the trustee, although they did not at any time threaten or attempt to exercise this power. P. 8.

Reply. Well, what of it? They cannot remove the trustee now, since they have asked it to start foreclosure proceedings.

(e) The minority bondholders (less than 2½%) can be protected only "in the federal court." P. 8.

Reply. This begs the question. The Circuit Court rightly held that the Petitioners had failed to discharge the burden on them in this behalf.

(f) The District Judge, say Petitioners, "took judicial notice"' of everything necessary to give him the power to approve the petition, although on certain statutory prerequisites no foundation was laid by factual allegations in the petition, nor was the deficiency supplied by actual proof. P. 9.

Reply. This proposition assumes to set aside the bankruptcy act, which requires that certain facts be *alleged* and *proved* (Secs. 130, 146), before the Court may take and retain jurisdiction in a reorganization proceeding when objection is timely and properly made.

(g) "Why does Bishop, said fiduciary * * * resist so vigorously the jurisdiction of the Federal Court?" P. 18.

Reply. Mr. Bishop is not a party to this proceeding. The record shows that he is merely interested as a co-owner of securities. He had a right to believe that his interests as a creditor would be adequately subserved in the proceeding in the state court with less delay and less expense. That is what nearly 98% of all creditors and security holders of the debtor seemingly think. This large group has a right to feel as it does and to prefer the state court procedure. The burden is on the 2% to show that the 98% are mistaken, and this they have failed to do, as the Circuit Court correctly holds.

Petitioners' memorandum argument is a rehash of their arguments in the Circuit Court, including the errors. We shall not take the time of this Court in answering each argument advanced. Counsel simply refuse to recognize the state procedure for reorganization under Sec. 90 of the Corporation Act of the State of Illinois and the general equity powers of the state court. This statute is quoted in Appendix A. A notable illustration appears on p. 16 of their Petition and Brief, where this gem occurs:

> "7. The court cannot compel the acceptance of a plan of reorganization nor to bind the dissenters to a plan of reorganization."

We cannot answer this one otherwise than by referring to Sec. 90 above, Appendix A and Appendix B, which show the exact contrary to be the law in Illinois.

Again, on p. 15, the theory of the upset-price in the state procedure is criticised. We answer this here, as we did below, by citing Sec. 216 (10) of the bankruptcy act, where the court is directed to sell the property "at not less than a fair up-set price." These are fair illustrations of criticisms against the adequacy of the state proceeding, all of which are captious, ill-informed, or both.

4. *Adequacy of State Proceeding.*

It is asserted by Petitioners and the Commission that *Marine Harbor Properties, Inc.* v. *Manufacturer's Trust Co.*, 317 U. S. 78, 88, was misapplied; but there this Court said:

> "In view of the burden on a petitioner to make the showing required by 130, paragraph (7) and 136, paragraph (4), the bankruptcy court is not warranted in assuming without more that a state foreclosure proceeding instituted for and on behalf of the first mortgage creditors exclusively is inadequate. * * *"

It is settled in this Court that the burden to prove the inadequacy of the state proceeding is on the Petitioners; the objecting creditor is not required, in the first instance, to prove its adequacy. Petitioners insist that this Court now change this rule. In view of the claim that the state proceeding affords insufficient protection to creditors and that the District Court could take "judicial notice" of that alleged fact, we quote in Appendix A the applicable State statute, and in Appendix B from our Reply Brief in the Circuit Court the portion thereof which contains the Illinois law on the powers and duties of equity in a reorganization proceeding.

II.

Reply to Commission Memorandum.

Grounds of Decision in Circuit Court Incorrectly Stated.

What we have to say in what follows is inspired solely by the contents of the Brief of the Commission as *Amicus Curiae*. We propose, however, to discuss this document frankly. In no other way can we discharge our duty to

this Court and to our client. The Commission begins by assuming and asserting, as we have pointed out in the case of the Petitioners, in their initial statement of the question that the issue is substantially narrower than in point of fact the record shows it to be, and then argues as if this too narrowly stated issue were the only question before the Court. The Commission says on p. 7 that the interpretation of Sec. 146 (4) makes the power of the Court to take and retain jurisdiction in a reorganization proceeding, where a prior proceeding is pending in a state court, depend upon "the outcome of a race of diligence." This straw man, R. O. Diligence, was paraded before the Circuit Court, and now an attempt is made to infuse the breath of life into his nostrils in this Court.

We cannot understand how lawyers familiar with the record could thus misinterpret it. The Circuit Court simply held that on this one point, among others in the case, the Petitioners in the District Court had failed to carry the burden of proof which the statute puts upon them and which this Court in the case of *Marine Harbor Properties, Inc.* v. *Manufacturer's Trust Co.*, 317 U. S. 78, 86, said rested upon them, namely to offer some evidence in the District Court, tending to show that the state proceeding inadequately protected the rights and interests of the Petitioners and creditors. No such fact was alleged and no proof of such fact was tendered in the District Court. The holding of the Circuit Court on this point is in exact keeping with the Federal statutes and the decisions of this Court.

Still working the straw man, counsel say that the effect of the holding of the Circuit Court is to repeal *pro tanto* Sec. 256 of Chapter X of the Bankruptcy Act. Pp. 7-8. This suggestion is, of course, completely preposterous. The

holding of the Circuit Court does not in any way, directly or indirectly, affect or concern Sec. 256; under that section a meritorious petition may be filed by qualified creditors upon pleading and proving the facts required by Secs. 130 and 146 of Chapter X.

Petitioners (p. 4) and the Commission (p. 4) pointedly refer to the fact that the Respondent paid $68.00 for the bonds he bought, although the bonds had a par value of $100.00. It is intended to create the impression that there was something unfair, underhanded, if not actually fraudulent, in this transaction. First we note that some of the Petitioners themselves paid only an average of $66.8 for these bonds. Petitioner-witness Caswell, himself a dealer in securities, testified that he paid 62 (Rec. 52) for some of the bonds he purchased and 69¾ for some. This Petitioner claimed to own $2100.00 face value of the securities which are listed to qualify the Petitioners. Helen Milis was listed as owning $300.00 and signed the petition, but testified that she never owned any (R. 5, 52, 54). Counsel for the Respondent have not pressed this obvious irregularity involving a misrepresentation as to the ownership of bonds by a Petitioner, an irregularity which, had it occurred on the side of the Respondent, would doubtless have been exploited to the limit. We make no point concerning the price paid for the bonds by either side, but in closing the discussion of this point raised by the Petitioners and the Commission, we call attention to the fact that the price paid by the Respondent was probably higher than the independent appraisal warranted (R. 119). Misstatements and insinuations on these points were made in the Circuit Court, were there, as here, corrected by us (Reply Brief, 22, 23)), but like Banquo's Ghost, they will not down.

On P. 6 the Commission tells this Court that the Circuit

> "Court reversed the order of the district judge *on the ground* that the petitioners had not established the inadequacy of the state proceeding for the protection of their interests * * * "

The statement quoted from the brief of the Commission is in keeping with the erroneous statement of the issue before the Court, to which we have adverted in discussing Petitioners' brief (page 4 *ante*), and we merely refer this Court to the quotation from Judge Kerner's opinion on p. 2 of this brief in opposition. This concise and lucid statement shows the *grounds* of the decision to be much *broader* and very different from what counsel state them to be. Inasmuch as the entire argument of counsel for the Petitioners is directed against and based upon this palpably incorrect representation of the decision of the Circuit Court, we shall be obliged again and again to refer to this foundation error in their argument.

The argument on pages 7 and 8, the reference to real estate corporations with "widely scattered public investors," the pedantic and irrelevant footnotes on p. 7, and the assertion that the decision of the Circuit Court "*pro tanto* repeals Sec. 256" of Chapter X, as heretofore pointed out, are no more than straw men who skulk freely through the protecting verbiage of the Commission's Brief. The debtor is the offspring of an unsuccessful reorganization in 1931, and there are no public "investors widely scattered." They are simply the participants in a former ill-considered "reorganization". They hold, in the form of bonds, certificates attesting their own lucklessness. The securities, are, therefore, not "held by the public," nor is it a case of "widely scattered security holders." *Securities*

and Exchange Commission v. *United States Realty & Improvement Co.*, 310 U. S. 434, 445, 446, 447.

Petitioners could not safely present the Court with a financial statement of the debtor, or put before the judge its record and its prospects. The simple and obvious fact is that it was not possible to represent to the District Judge that there was a reasonable possibility of successful reorganization without approaching dangerously close to the boundary between good faith towards and actual fraud upon the District Court.

Beginning on p. 8, the Commission charges certain Circuit Courts with denying the "paramount bankruptcy power" in favor of state proceedings and with making "unjustified assumptions as to the adequacy" of these state proceedings which "Chapter X was intended to supplant." This is not even plausible. Congress did not intend to "supplant" adequate state proceedings, and the Circuit Court in this case made no "unjustified assumption" as to the adequacy thereof. Congress, on the contrary, intended to prevent unnecessary removal of cases from the state courts, and we refer to the report of the House Committee of the Judiciary, No. 1409, 75th Congress, 1st Session, filed July 29, 1937, to accompany H. R. 8046, on this point:

> " 'Good faith' is defined in terms which codify the rules variously laid down by the courts, but not uniformly and at times in conflict. This definition will help toward keeping out proceedings which properly belong under Chapter XI and will stop the removal of prior pending cases from other courts where the interests of creditors and stockholders would be better served by retaining and continuing the prior proceedings."

Congress put the burden to prove the inadequacy of the

state proceeding on the Petitioners, and the Circuit Court found that they had failed to discharge this burden. That Court did *not assume* that state proceeding was adequate; the District Judge *assumed without any evidence that it was inadequate,* and this the Circuit Court held error. The statutes and the decisions of all courts sustain this view. The Petitioners now ask this Court to toss all these prior rulings, as well as the intent of Congress, into the legal ash can.

The suggestion on p. 9 that this Court redefine "good faith" is a request that this Court set aside the will of Congress and overrule the prior decisions of the Court itself. It is an invitation to destroy that minimum certainty in the law which cannot be maintained, if the remaining vestige of the doctrine of *stare decisis* is to be thus thrown away, and we are to adopt the legal practices of Continental Europe. The demand for this "clarification" really involves an almost offensive assumption that this Court is so addlepated that it does not know its legal mind from one term to the next. In the *Marine Harber Properties* case this Court said that the burden to show the inadequacy of the state proceeding was on those who assert it—the Petitioners—and in so saying, the Court simply gave expression to the will of Congress as clearly expressed in the statutes. That this needs any "clarification" to those who can read the English language, is nonsense.

The discussion of Sec. 256 of Chapter X on pages 9, ff. of the Commission Brief again introduces the pet phrase, "race of diligence," which the authors of the argument seem to hold in the highest veneration. Sec. 256 must be read with Secs. 130 and 146. The former is intended to preclude the argument that a prior state proceeding pre-

vents the filing of a petition, while Sec. 130 and especially Sec. 146 (4) make it possible that a state proceeding may be adequate and put the burden on the one denying the adequacy to offer some proof in support of his denial thereof. There is obviously no "race of diligence" or any other kind of a race; each case is governed by its own facts, wholly without regard to time. The fact that the state proceedings is started first affords no advantage; the court must be satisfied of its adequacy, but the burden is cast by the law upon him who goes into the bankrupcy court, on the theory that the state proceeding does not protect him. This is simple; it is well understood; Congress intended it. Why scrap it all now?

On p. 9 of the Commission Brief an attempt is made to persuade this Court to believe that the Circuit Court interpreted certain quoted language in the *Marine Harbor Properties* case as a ruling by the United States Supreme Court that in all cases where but "one class of securities" was involved, "prior proceedings are to take precedence," and that the "consequence is virtually to preclude the availability of Chapter X where only a single class of creditors is substantially interested," and thus (p. 8) "to deny the invocation of the paramount Federal bankruptcy power in favor of the prior state court proceedings." Of course, if we may be permitted to say so, no such argument was made in the Circuit Court, and, to a mind carefully seeking the truth, no such thought is suggested by any statement, phrase or hint in the opinion of that distinguished tribunal

Again and again we call attention to the fact, avoided in the ingeniously confusing argument of counsel for the Commission, that the Circuit Court reversed the District Court because the Petitioners failed to discharge the burden the bankruptcy act lays on them, to allege and prove

certain fundamental facts essential to the power of the Court to take and retain jurisdiction in the face of a challenge duly interposed. The bankruptcy power is only as "paramount" as Congress chooses to make it, and Congress chose not to make it *prima facie* "paramount" so as to exclude state proceedings without a showing of inadequacy.

Otherwise, put, this is not a question of the paramountcy of the bankruptcy power—which is in Congress—but whether Congress granted the District Court a jurisdiction in all circumstances paramount to that of the state courts. This Congress did not do, and this case is, in so far as the stated proceeding is concerned, one where the circumstances did not justify the action of the District Court in approving the petition.

On p. 13 we are told that the courts should have remanded and not ordered a dismissal. Here again counsel do not seem to agree with Congress—Sec. 141 of Chapter X specifically requires a dismissal in this case, since Petitioners failed to show good faith.

The Commission acts as if Petitioners represented substantial holdings. One petitioner, Miss Milis, said she never received any bonds. R. 54. That leaves a balance of about 2% of the total second issue bondholders. While the fact that the Petitioners have only an insubstantial interest may not be of controlling importance, it is persuasive of a fundamental want of equity in their position. Perhaps this explains why counsel in both briefs are driven in innuendoes and imaginings in an effort to cast doubt upon the good faith and fairness of the 98% who do not seem to care to take this simple case into the Federal Court. The Commission and the Petitioners contend for that minority rule

decided by Judge Moscovitz; Commercial Law Jc., Feb. 1945, pp. 31-35.

On p. 13 the astonishing assertion is made that the powers of the state equity courts are no greater "than those in an equity receivership proceeding, the traditional inadequacies of which led to the bankruptcy reorganization statutes." The Illinois statute, Sec. 90 of the Corporation Act of the state (Appendix A), is based on the English Companies Act on reorganization, and the Illinois Supreme Court has held that courts of equity in that state in effect have all the powers of the federal courts in bankruptcy, including control of reorganization committees, of the sale, of the plan, and full power to protect the smallest and most "widely scattered minorities." Appendix B. This assertion in the Commissioner's Brief is strangely at variance with the facts.

On p. 13 we find this statement:

> "While the equitable jurisdiction of the State Courts may afford safeguards against gross abuse in foreclosure suits, their powers are not greater than those in an equity receivership proceeding * * *"

This is the first time that we have been advised that abuses in equity proceedings are classified on the basis of degrees of grossness. We do not believe that any further comment is needed beyond the fact that counsel admit the fact, for a fact it is, that the State Courts have the power to protect against abuse, whether "gross" or otherwise.

On pp. 13 and 14 counsel for the Commission take the position that "type of proceeding" rather than the characteristics of the individual case should, upon being proved, be decisive upon the power of the court to proceed, notwithstanding a prior state proceeding. This, obviously, is

not the test Congress laid down, nor has any such test been suggested in any decision of this Court or of any federal court. Congress and the decisions require that the Petitioner under Chapter X of the Bankruptcy Act allege and prove facts in each case— not a *type* of case— in the District Court which would authorize the court to take and retain jurisdiction over objections duly made.

The discussion and note on p. 14, calculated to show the superiority of Chapter X over any state procedure, lead to the inevitable conclusion that *no* case could possibly exist where a state proceeding would adequately subserve the interests of creditors. It also *assumes* as a premise that the state courts will not do their duty, or are incapable of seeing what their duty is, and, if seeing it, unwilling to perform it. For example, we note that the argument is based on the idea of an "independent trustee." P. 13, note. Such an argument could be advanced in *every* case and if accepted, no case would ever remain in a state court. Congress intended no such result.

We cannot escape the conclusion that, beginning on p. 15, Division II of the Commission Brief, the authors drew more freely on their imagination than upon the record. After purporting to describe the safeguards available under the state procedure, counsel say (p. 16) that the

> "Circuit Court's view of the Illinois law, however, is a very optimistic one and apparently much more advanced than that of the state court itself."

The statements which follow are calculated to minimize the state safeguards. It is respectfully submitted that counsel could not have made these statements and insinuations of record, had they read the state cases and the state statute, Sec. 90. We refer this Court to Appendix B, where the

holdings of the Illinois courts on this subject are fully set forth and where it appears that the Supreme Court is of the opinion that the equity courts in Illinois have substantially *all* the powers of the bankruptcy court in relation to the rights of minorities and their protection.

Most statements on p. 16, whether of law or of fact, are incomplete, inaccurate or contrary to fact. For example, the statute that the power of the state court to fix an upset price relates to a price that "may only be one which is not so grossly inadequate as to shock the conscience of a court of equity"! This brain brat is fathered solely by counsel. The Illinois Court has no responsibility for its parentage. On the contrary, as appears in Appendix B, the Court is said to be the vendor and has full control of the price and complete power and duty to protect the smallest minority. These statements in the brief are gross misrepresentations of the Illinois law.

Plans may be filed at any reasonable time, and the Court has the same control over them as has the federal court.

The "advantages" of Chapter X listed on page 17 are adequately available under the state procedure. The state court has the power to provide an independent trustee or receiver.

III. Conclusion.

The Petitioners failed to prove a single fact which tended to show that their rights could not be fully protected in the state courts. The burden was on them to show some such fact. In this they failed, and the Court so held and hence dismissed their petition.

The Circuit Court did *not* hold that the state procedure in Illinois was *in all circumstances* as adequate as the federal procedure. It simply held that in *this particular* case Petitioners had failed to sustain the burden of proof that the state procedure did not adequately protect their rights. This holding this Court cannot disturb without upsetting certain fundamentals of established bankruptcy and reorganization procedure.

It is argued that there must be a "realistic" approach to this problem. So there must, and so felt the Circuit Court, for it ordered a dismissal, since no hope of successful reorganization was made to appear or even suggested. Liquidation in a reorganization proceeding seems to have been the object of the Petitioners, bringing the petition within the condemnation of the case of *Fidelity Assurance Association* v. *Sims,* 318 U. S. 608.

The petition for a Writ of Certiorari should be denied.

Respectfully submitted,
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APPENDIX.

Illinois Statute Relating to Reorganization of a Corporation

"When a compromise or reorganization of the corporation is proposed, whether the suit shall have been instituted by a shareholder or by a creditor, the court, upon the summary application of any shareholder, or creditor, or receiver may order a meeting of the creditors or shareholders to be summoned in such manner as the court may direct. If a majority in number representing three-fourths in value of the creditors or the holders of three-fourths of the shares entitled to vote thereon, or both, or if a majority in number representing three-fourths in value of any class of creditors, or if the holders of three-fourths of the shares of any class, as the case may be, agree to any compromise or reorganization of the corporation, such compromise or reorganization, if approved by the court, shall be binding on all creditors or on all shareholders, or both, or on the class of creditors or class of shareholders, or both, as the case may be, and also on the corporation and its receivers, if any." Sec. 90 (c), Illinois Business Corporation Act, Smith-Hurd Ann. Stat. Ill., Ch. 32, Sec. 157.90 (c).

In view of the attack on the Illinois reorganization procedure, we call attention to the fact that the statute above quoted is based on Sec. 153 of the English Companies Act of 1929, and on Sec. 59 of the Uniform Business Corporation Act. The Delaware Act. Sec. 5 (9), is similar in its terms. The English statute is the result of many years of

experience in that country with reorganization and the Uniform Act represents the best thinking of many able American lawyers on the subject. Sec. 90 (c) is, in every jurisdiction, regarded as endowing equity courts, with ample powers to reorganize any industrial corporation within its jurisdiction and to protect fully all minority interests. Criticism in the brief of *Amicus Curiae* is obviously ill-advised, and the cases cited are against, not for, the contention there made.

The case of *First National Bank* v. *Bryn Mawr Bldg. Corp.*, 365 Ill. 409 (1937), is a complete refutation of the theoretical attack on the powers of equity courts in Illinois to control and supervise completely every detail in reorganization and to protect fully all minority interests. There the fairness of the plan approved was attacked and sustained, as was also the fairness of the sale. The jurisdiction of the court to entertain a plan of reorganization, proposed long after the foreclosure proceeding was begun, was upheld in all respects. The case stands as an unshakable landmark in the law against every claim that the minority could not or cannot be fully protected in the state proceeding, through the filing of a plan or otherwise, should they feel the need.

This reorganization statute gives the chancery court in Illinois *all* the powers of the federal court in relation to the reorganization of a corporation, whether initiated as a reorganization or the reorganization takes place in connection with a foreclosure proceeding, as indicated in *First National Bank* v. *Bryn Mawr Bldg. Corporation*, 365 Ill. 409.

APPENDIX B.

Powers of Equity Courts in Illinois.

These propositions are settled law in Illinois and bear directly upon the powers of equity, both under and independently of statute, to control the disposition of property in a foreclosure or a reorganization proceeding in that state:

1. The "equity powers of state courts are no more limited than those of the Federal courts, and * * * equity jurisdiction over mortgage foreclosure is general rather than limited or statutory." *Levy* v. *Broadway-Carmen Bldg. Corp.*, 366 Ill. 290 (1937).

2. The jurisdiction is not limited to the sale of the property. "If it may reasonably be seen that the exercise of the jurisdiction of a court of equity beyond the sale of the property will result in better protection to parties before it, it would seem not only to be germane to matters of undisputed jurisdiction, but to make for the highest exercise of the Court's admitted functions." *Ibid.*, p. 290.

3. "A court of equity has jurisdiction, in connection with an application for approval of a foreclosure sale, to approve a reorganization plan submitted by a bondholders' committee." *Ibid.*, p. 290; *First National Bank* v. *Bryn Mawr Beach Bldg. Corp.*, 365 Ill. 409.

4. In connection with a foreclosure or a reorganization, the court may fix an up-set price for the sale of the property *Levy* v. *Broadway-Carmen Bldg. Corp.*, 366 Ill. 289.

5. The control of equity over the sale under a foreclosure is sweeping and complete. "Unfairness from any cause which operates to the prejudice of an interested party, will abundantly justify a chancery court in refusing to approve a sale." *Ibid.*, 287.

6. "Confirmation (of a sale)is a final consent, and the court, being in fact the vendor, may consent or not, *in its discretion.*" *Ibid.*, 286.

7. "If the plan (of reorganization) is unfair, or appellants are in danger of being 'frozen out,' a court of equity should extend its aid to those who, by reason of their numbers and widely scattered abodes, are unable to protect themselves against an unconscionable plan or a scheme to prevent the sale of the property at a fair price." *First National Bank* v. *Bryn Mawr Bldg.*, 365 Ill. 420.

8. The equity court has complete control over bondholders' committees and "the supervision of a court of equity for the protection of all bondholders" is complete as it is in the federal courts. *Ibid.*, 423.

9. In Illinois, as in the federal bankruptcy court, "The court is concerned with the fairness of the bids as to those bondholders who have not adopted the plan." *Ibid.*, 426.

10. The court under Sec. 90 (c) and under its general equity powers can issue process to all security holders and can make them parties by representation; in the case of a suit by an indenture trustee to foreclose, all secured bondholders are represented by him. *Ibid.*, 431.

11. To which we now add the following: "It is not pointed out wherein equity jurisdiction and powers of state courts are to be considered more limited than those of the Federal courts." *Ibid.*, p. 417.

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1945

No. 250

CORNELIUS J. COLLINS, ET AL.,
Petitioners,

VS.

LESTER L. SEIFRIED,
Respondent.

SHERIDAN VIEW BUILDING CORPORATION,
Debtor.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

PETITIONERS' REPLY BRIEF.

We will not burden the Court with an extended reply to Respondent's brief in opposition to Petitioners' application for a Writ of Certiorari. We have confined our reply to the following matters:

I.

Respondent in his brief in opposition to the Petition for a Writ of Certiorari states that no ground for certiorari exists under Rule 38 of this Court, and that, therefore, certiorari should be denied.

It is the contention of the petitioners that the decision of the Circuit Court of Appeals in the instant appeal improperly extended and misapplied the authority of the decision of this Court in the case of *Marine Harbor Properties, Inc.*, 317 U.S. 78. If this be true the decision of the Circuit Court of Appeals is probably in conflict with the decision of this Court within the meaning of Rule 38 (5) (B) of this Court.

The opinion of the Circuit Court of Appeals in the instant appeal quotes as the basis of its decision some of the language set out in the opinion of the *Marine Harbor* case. The facts, however, in the *Marine Harbor* case were entirely different from the facts in the instant appeal in that (1) the debtor was insolvent and therefore could not participate in the Federal Court or any Court; (2) there was no conflict between creditors; (3) the one class of creditors entitled to participate could obtain in the State Court foreclosure and liquidation of the debtor's estate and the application of the proceeds thereof to their debt. Thus it can be said that the interest of creditors would be best subserved in the prior foreclosure proceeding and there was no need for a proceeding in the Federal Court. With this in mind this Court said in its opinion in the *Marine Harbor* case that when a prior proceeding is pending the Petitioner's showing of "need for relief" must demonstrate that in some substantial particular the prior proceedings withhold or deny creditors or stockholders benefits, advantages or protection which Chapter X affords.

In the *Marine Harbor* case the debtor could not participate in either Court and therefore was not denied in the State Court any advantage or protection which Chapter X affords. The Circuit Court of Appeals in the instant appeal has interpreted said decision to mean that where there is a State Court foreclosure pending the equity jurisdiction of the foreclosure Court is general and the Court has ample power to protect one creditor against the undue advantage of another; that said Court has power to supervise a sale and to approve or reject the report of sale which operates to the prejudice of an interested party. The foreclosure Courts of Illinois with their general equity jurisdiction had this power before the passage of Chapter X by Congress. The effect of the decision of the Circuit Court of Appeals in the instant case where there is a foreclosure pending in the State Court is to hold meaningless Section 256 of Chapter X which provides that a petition may be filed in the Federal Court not withstanding the pendency of a prior mortgage foreclosure or other proceeding in another Court. Obviously this was not the intention of Congress as the very pendency of a proceeding to foreclose a mortgage is one of the essential allegations of a creditor's petition under Section 131 (4) of Chapter X. The practical effect of this decision would result in a race between creditors as to which forum best suited these particular needs, and would bar a Chapter X proceeding when a foreclosure proceeding is pending in the State Court.

We do not think this Court meant by its language in the *Marine Habor* case quoted by the Circuit Court of Appeals in the instant case to hold that in all cases where there was a pending State Court foreclosure that a Chapter X petition should be dismissed but that under the facts as they existed in said case the interest of the only class of creditors would be best subserved in the State Court.

II.

Respondent on pages 10 and 11 of his brief is in the opinion of petitioners shadow boxing with a proceeding which exists only in his imagination. In speaking of the adequacy of the State Court proceeding respondent leans heavily on Section 90 of the Illinois Business Corporation Act as though this section were before the State Court in the pending foreclosure proceeding. The only prior proceeding pending is a simple foreclosure which seeks a sale of the debtor's property. There is no action pending for a reorganization of the debtor corporation under the Illinois Business Corporation Act. Section 146 (4) of Chapter X speaks of a prior proceeding *pending* in any Court. The answer of respondent states said proceedings are now ready for decree (Rec. 11). Obviously if there were no foreclosure pending in the State Court it would be impossible for respondent to object to the jurisdiction of the Federal Court by asserting that there was a State reorganization statute providing for the reorganization of a corporation. Does respondent expect petitioners at this time to commence an original action for reorganization of the debtor in the State Court. It is conceded that the foreclosure courts have equity powers, but even these powers do not authorize an equity court to reorganize a corporation in the pending prior proceeding which is a foreclosure proceeding.

III.

It is admitted that Bishop owns 66% of the indebtedness of the Debtor, but respondent on pages 10 and 18 of his brief has adopted the balance of the bondholders so that he now assertedly speaks for 98% of said bondholders. This adoption on his part is not supported by the record.

Bishop, as attorney for the indenture trustee when he prepared and filed the foreclosure in the State Court did not make the bondholders who he has now adopted parties to said foreclosure suit, and did not cause any notice thereof to be sent to them. The very effect of the retention of jurisdiction by the Federal Court will be to give that unrepresented substantial group of bondholders an opportunity to speak for themselves and not be compelled, as they now are, to be represented in said State Court by respondent who is in charge of said proceeding, and with selfish motives could be guilty of abuse.

The instant case warrants the full consideration of this Court to the end that uncertainty and confusion in the jurisdiction of the Federal Court in a Chapter X proceeding be eliminated.

Respectfully submitted,

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